

Korea Views

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Demise of the North Korean leader—our initial views: Political uncertainties rise in the North but we see fairly limited downside risks for the South

North Korean TV reported earlier today (December 19) that Kim, Jong-il, the leader of North Korea, died in the morning of December 17. Details were not released but South Korean newspapers report that the death was sudden and was not known to the South Korean government.

We do not see much immediate impact on the economy of South Korea while political uncertainties are rising in the North. First, the poor health of the leader has been well known and both sides of the Korean peninsula have been in preparation for this contingency for several years. The North Korea regime has already selected Kim, Jung-un, the leaders' third son, as the successor. The South Korean government has a contingency plan, entailing counter measures ranging from intensive monitoring to market interventions and possible support from allies and international financial institutions.

Second, economic linkages between South and North Korea are very limited with little contagion from possible regime change in the North Korea. Bilateral trade has been relatively stagnant since the sinking of the Chonan naval ship and the shelling of Yeonpyung Island, with total bilateral trade at around US\$1 billion (see *Rising North Korean risks do not alter our positive KRW view*, Korea Views, April 23, 2010). The Kaesung Industrial Complex, the only remaining joint venture between the South and North, is operating normally.

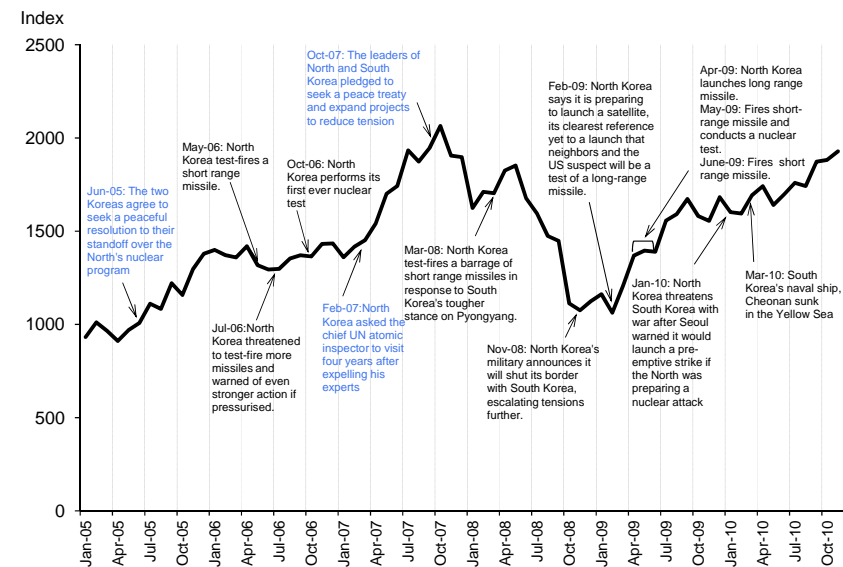
Third, we think it is unlikely that there will be a lasting impact from the demise of Kim Jong-il on financial markets. Historically, the impact of events in North Korea on the KOSPI has not lasted more than a week (see Exhibit 1) and we do not see any reason why the situation would be any different now.

Beyond the near term, North Korea is likely to enter into a transition to a succession arrangement, for which implications will depend on scenarios. While it is difficult to foresee how its political and economic systems will evolve, excluding the chance of military action, the process is unlikely to affect adversely the South Korean economy in our baseline scenario of gradual integration. We have been highlighting this as a most likely scenario, given the apparently strong political consensus in South Korea against a German-style unification. An alternative scenario, which is fairly unlikely now, is a rapid and subsidy-based unification, which would be prohibitively expensive in Korea due to the large gaps in the living standards and relatively small gap in population. The third scenario, of which the odds are substantial, is the status quo.

Under our baseline scenario, we see more upside in the medium and long-term outlooks, given the potentially large synergies between the two Koreas, in terms of natural resources, technology, capital and demographics (see *A United Korea? Reassessing North Korea Risks (Part I)*, Global Economics Paper No. 188, September 21, 2009).

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Exhibit 1: KOSPI impact of North Korea events has been short-lived



Source: GS Global ECS Research.

I, Gooheon Kwon, hereby certify that all of the views expressed in this report accurately reflect personal views, which have not been influenced by considerations of the firm's business or client relationships.

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